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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1941.

SCHERCK, RICHTER COMPANY, a Corporation,
Petitioner,

vs.

THOMAS N. DYSART and FREDERICK W. STRAUS, as Members of the Central Properties First Mortgage Bondholders' Committee, and AMBASSADOR BUILDING CORPORATION, a Corporation,
Respondents.

No. 930

PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals
for the Eighth Circuit
and

SUPPORTING BRIEF.

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PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals for the Eighth Circuit.

MAY IT PLEASE THE COURT:

The petition of Scherck, Richter Company, a corporation, respectfully shows to this Honorable Court:

I.

SUMMARY STATEMENT OF MATTER INVOLVED.

Your petitioner seeks to review the decision of the Circuit Court of Appeals for the Eighth Circuit rendered on November 17, 1941 (R. 211-222), and in which a petition for rehearing was overruled on December 5, 1941 (R. 233), wherein the Court of Appeals affirmed a decree of the Dis-

trict Court, entered February 4, 1941 (R. 84), approving a plan submitted by the Central Properties First Mortgage Bondholders' Committee for the disposal of assets, and disapproving an alternative plan submitted by the petitioner for the disposal of these assets.

The opinion of the Circuit Court of Appeals is reported at 123 F. (2d) 364.

The decree in the District Court was entered after a hearing on a report and a petition filed on September 23, 1940, by the respondents, Thomas N. Dysart and Frederick W. Straus, as members of the Central Properties First Mortgage Bondholders' Committee (R. 28). The plan submitted by the Committee was embodied in the contract dated July 26, 1940, entered into between the Committee and the Ambassador Building Corporation, and was appended to the report and petition (R. 31). The District Court entered an order setting the matter down for hearing and directing the Bondholders' Committee to mail notices of the hearing together with copies of their report to the holders of certificates of deposit (R. 42-44).

The petitioner, as a holder of certificates of deposit of the face value of $11,400.00, filed objections to the plan and submitted an alternative plan (R. 61). Another certificate holder, Julia A. Healy, filed objections to the plan (R. 55). No other certificate holders appeared at the hearing. The Court approved the plan of the Bondholders' Committee as fair and equitable and disapproved the petitioner's plan (R. 78-85).

The proceedings which led up to the decree are characterized by the Court of Appeals in its opinion "as supplemental to and in aid of an equitable reorganization proceeding, the history of which will be found set out in great detail in the opinion of Judge Stone, speaking for this Court in Warner Brothers Pictures, Inc., v. Lawton-Byrne-Bruner Insurance Agency, 79 F. (2d) 804" (R. 211-212).

That case, decided October 31, 1935, confirmed a plan of reorganization herein referred to as the original plan, which was approved by the District Court by its decree of July 5, 1934, and this original plan, while not involved in these proceedings, is the background for the supplemental plan involved in this case. The supplemental plan, often referred to in the record as a plan of disposal, is in essence a plan of reorganization.

The respondent, Ambassador Building Corporation, is the corporation which was organized under the original plan of reorganization and thereby acquired a large office and theater building at Seventh and Locust streets in St. Louis, Missouri, and issued the new securities under the original plan (R. 30).

Under the original plan the holders of certificates of deposit for the First Mortgage Bonds received income bonds of the Ambassador Building Corporation in the face amount of the bonds and also voting trust certificates representing 65 per cent of the stock in the company. Voting trust certificates for 25 per cent of the stock were allotted to second mortgage bondholders and 10 per cent was reserved for management (R. 219). The voting trust continues until 1953. The respondent, Thomas N. Dysart, is Chairman of the Bondholders' Committee, is a voting trustee and is President of the Ambassador Building Corporation, and is also President of the St. Louis Amusement Company. The only other active member of the Committee is the respondent, Frederick W. Straus, connected with S. W. Straus and Sons, the investment house which brought out the securities. One member of the Committee has resigned and another has become incapacitated by reason of illness (R. 121-122).

The assets dealt with in the supplemental plan did not pass under the original plan of reorganization. These assets, hereinafter described, were recovered by the Bond-

holders' Committee for the holders of certificates of deposit by reason of a claim against Skouras Brothers Enterprises, Inc., which had guaranteed the first mortgage bonds. This claim had not been realized upon at the time of the confirmation of the original plan of reorganization and it was provided in the original plan (R. 80) that in the event that the Committee should recover any amounts on this guaranty by Skouras Brothers Enterprises, Inc., then "the amount so recovered shall be distributed pro rata to the holders of certificates of deposit evidencing deposited first mortgage bonds."

In the decree of the District Court confirming the original plan of reorganization the District Court had reserved jurisdiction "for the purpose of supervising the carrying out of said plan of reorganization and determining that securities have been distributed pursuant to said plan of reorganization to the persons entitled thereto." These provisions set out in the decree (R. 80) are the only basis for the jurisdiction of the District Court in entering the decree approving the supplemental plan.

The assets dealt with by the supplemental plan were acquired by the Bondholders' Committee on November 4, 1936, and the realization was reported to the Court in a report filed by the Bondholders' Committee on May 25, 1937 (R. 9). No plan for distribution of the assets or for sale, disposal or reorganization was submitted to the Court until September 23, 1940.

As stated by the Circuit Court of Appeals in its opinion the assets dealt with in the supplemental plan belong exclusively to the holders of certificates of deposit (R. 220). The outstanding certificates aggregate $3,468,200. By reason of the lapse of time and the extensive trading in the new securities issued under the original plan of reorganization the holders of the certificates of deposit as a class can no longer be identified with the security holders of the

Ambassador Building Corporation. Certificate holders, including the petitioner, representing in the aggregate 30 per cent of the total amount outstanding have sold their income bonds and voting trust certificates received in the original plan of reorganization. These certificate holders who have sold their bonds are no longer interested in the Ambassador Building Corporation, but nevertheless do retain their pro rata interest in the assets held by the Bondholders' Committee and conversely the purchasers of these new securities do not step into the shoes of the holders of the certificates of deposit and have no rights or interest in these assets held by the Committee. Neither does the Ambassador Building Corporation nor the 35 per cent interest allotted to persons other than First Mortgage Bondholders have any interest in these assets (R. 117-127).

The assets dealt with by the supplemental plan are detailed in the opinion of the Circuit Court of Appeals (R. 213) and are here summarized as of the date of the contract with the Ambassador Building Corporation of July 26, 1940. These assets are:

1. 52% of the outstanding stock of the St. Louis Amusement Company.
2. $41,000.00 par value of First Mortgage Notes of West End Lyric Theatre, worth par.
3. $51,000.00 of second mortgage notes from St. Louis Amusement Company, worth par.
4. $8,000.00 in cash.
5. Miscellaneous assets of no considerable value.

The St. Louis Amusement Company operates twenty-six motion picture theatres in the St. Louis District, some of which it owns in fee and others which it holds under leaseholds (R. 90-97). As of the date of hearing the net worth of the company was $663,472.95, and the fifty-two per cent interest had a book value of $344,850.00 (R. 96). This represents a valuation of $9.90 per $100.00 of bonds of the

outstanding certificates of deposit amounting to $3,468,-200.00.

The fifty-two per cent interest in the St. Louis Amusement Company is subject to a ten-year option granted to Fanchon & Marco Enterprises, Inc., on July 30, 1936 (R. 34). The details of the option agreement need not be considered and the transfer of the St. Louis Amusement Company stock to the new corporation under the plan is subject to this option.

The plan of the Bondholders' Committee approved by the decree is summarized in the opinion of the Court of Appeals (R. 213-215). Essentials of the plan may be simplified as follows:

1. A new corporation is organized by the Committee with an authorized issue of preferred shares and common shares. The preferred shares are a $12.00 non-income liquidating stock without voting rights, the voting rights being exclusively in the common stock.

2. The Bondholders' Committee transfers to the new corporation the fifty-two per cent stock interest in the St. Louis Amusement Company subject to the option to Fanchon and Marco Enterprises, and the miscellaneous assets (not including, however, the $92,000.00 in mortgages and the $8,000.00 in cash) for which it receives all of the authorized stock of the new corporation, preferred and common.

3. The Bondholders' Committee distributes to the holders of certificates of deposit one share of preferred stock for each $100.00 par amount of bonds represented by the certificates of deposit.

4. The Bondholders' Committee transfers to the Ambassador Building Corporation all of the common stock of the new corporation and the mortgages held by the Committee of the par and actual value of $92,000.00 for all of which the Ambassador Building Corporation pays the Committee $57,000.00 by canceling the Committee's indebtedness to it in the amount

of $35,000.00, and by furnishing the Committee with $22,000.00 to pay the compensation and expenses of the Committee and its counsel. The Ambassador Building Corporation also agrees to hold the Committee harmless from any liability incurred under the plan and offers to buy at $8.00 per share the preferred stock issued to certificate holders who sold their bonds in the Ambassador Building Corporation prior to May 1, 1940.

The factual basis underlying the contention of the petitioner that the plan of the Bondholders' Committee is inequitable is summarized by the Court of Appeals as follows (R. 219):

> 1. The holders of the certificates of deposit in fact own the 52 per cent of the stock in the St. Louis Amusement Company and no others have any beneficial interest therein.
>
> 2. The Ambassador Building Corporation, which will receive the common stock in the new corporation, cannot be identified with the holders of certificates of deposit because about 30 per cent of the new bonds issued by that corporation are held by persons who have bought the bonds since the original plan was consummated, and who have no claim to the 52 per cent in the St. Louis Amusement Company.
>
> 3. Of the stock authorized and issued under the original plan of reorganization 25 per cent was allotted to second mortgage bondholders and 10 per cent to the management, and these interests have no claim to the 52 per cent of the stock in the St. Louis Amusement Company.

Advantages from the Committee's plan would be derived by those who have no interests in the assets dealt with.

> 1. Control of the St. Louis Amusement Company will pass to the voting trustees of the Ambassador

Building Corporation who under the agreement function until 1953.

2. Holders of income bonds of the Ambassador Building Corporation in the amount of approximately $1,000,000.00, representing 30 per cent of the outstanding bonds, will share equally with those who are holders of certificates of deposit and all the benefits and advantages derived from the ownership of the common stock in the Ambassador Investment Corporation.

3. Subject only to the superior rights of the income bondholders and the holders of voting trust certificates the 35 per cent of the stock of the Ambassador Building Corporation allotted to second mortgage bondholders and its management will participate in the benefits and advantages derived from the ownership of the common stock in the Ambassador Investment corporation.

The alternative plan submitted by the petitioner, referred to in the record as the Scherck, Richter plan, is summarized by the Court of Appeals in its opinion (R. 217-219). We here summarize only what we consider the obvious advantages to the cerificate holders of that plan over the plan of the Bondholders' Committee.

1. The new corporation will own not only the 52 per cent of the stock in the St. Louis Amusement Company, but also 42 per cent of the stock contributed by Fanchon and Marco Enterprises, and will thus have the earning power of 96 per cent of the stock.

2. Fanchon and Marco Enterprises will take a subordinate preferred stock for its 42 per cent interest in the St. Louis Amusement Company, on the same basis as used in the allotment of first preferred stock to the certificate holders.

3. Scherck, Richter Company will contribute $100,020.00 in cash by purchasing second preferred stock on the basis of $15.00 per share.

4. The certificate holders will receive instead of the $12.00 nondividend liquidating preferred stock, as provided in the plan of the Bondholders' Committee, a $15.00 preferred stock with prior rights to dividends at the rate of 5 per cent per annum, and with prior rights to all stock in liquidation.

5. For the subordinate position taken by Scherck, Richter Company and Fanchon and Marco Enterprises for the new capital contributed they will receive the common stock carrying the voting rights in the corporation.

II.

JURISDICTION.

1. The judgment of the Circuit Court of Appeals for the Eighth Circuit to be reviewed was rendered on November 17, 1941 (R. 222), and the petition for rehearing filed by the petitioner in that Court was overruled on December 5, 1941 (R. 233).

2. The statutory provisions which are believed to sustain the jurisdiction of this Court are:

> Judicial Code, Section 240 (a), as amended by the Act of February 13, 1925, 28 U. S. C. A., Section 347 (a), 28 U. S. C. A., Section 350.

3. The judgment of the Circuit Court of Appeals is a final decree in equitable proceedings for reorganization which may be reviewed by this Court in the exercise of its discretionary powers. It is believed the decree departs from the controlling principles announced by this Court in equity and bankruptcy reorganizations and the reasons for the exercise of the discretionary power of this Court to grant the writ of certiorari are stated under Point IV, "Reasons for Allowance of Writ."

III.

THE QUESTIONS PRESENTED.

1. May a plan be declared fair and equitable and within the absolute priority rule of the Boyd case, which permits a Bondholders' Committee to transfer assets belonging absolutely to the depositing bondholders to a new corporation, gives to the bondholders preferred stock in the new corporation, and gives to another corporation without real consideration the common stock of the corporation acquiring these assets?

2. May such a plan be sustained as involving the determination of a matter of business policy by reason of the fact that 70 per cent of the depositing bondholders are also bondholders of the corporation which acquires the common stock in the new corporation to which the assets of the depositing bondholders are to be transferred?

3. May such a plan be sustained as fair and equitable when another plan is submitted to the Court by a depositing bondholder which is free of the alleged inequities of the plan of the Bondholders' Committee and which gives to the depositing bondholders a better and more valuable security position?

4. May a court of equity in approving a plan submitted by the Bondholders' Committee as having resulted from arm's length negotiations disregard the fact that the chief sponsor of the plan occupies a position of conflicting loyalties, in that he is chairman of the Bondholders' Committee and also a voting trustee and president of the corporation to which is given without consideration the common stock and complete voting control of the new corporation which will acquire the assets belonging to the depositing bondholders?

IV.

REASONS FOR ALLOWANCE OF WRIT.

1. The decision of the United States Circuit Court of Appeals in holding that the plan submitted by the Bondholders' Committee for the disposition of the assets owned by the depositing bondholders is fair and equitable is directly contrary to and in conflict with the absolute priority rule announced in following applicable decisions of the Supreme Court of the United States:

Northern Pacific Railway Company v. Boyd, 228 U. S. 482;
Kansas City Terminal Ry. Co. v. Central Union Trust Company, 271 U. S. 445;
Case v. Los Angeles Lumber Products Company, 308 U. S. 106;
Consolidated Rock Products Company v. Du Bois, 312 U. S. 510.

2. The decision of the United States Circuit Court of Appeals in holding that the approval by the District Court of the plan submitted by the Bondholders' Committee and its disapproval of the plan submitted by the petitioner presented "a question of business policy calling for the exercise of business judgment" and was within the discretionary power of the District Court is in conflict with the following decisions of the Supreme Court of the United States:

National Surety Company v. Coriell, 289 U. S. 426;
First National Bank v. Flershem, 290 U. S. 504;
Case v. Los Angeles Lumber Products Company, 308 U. S. 106;
Consolidated Rock Products Company v. Du Bois, 312 U. S. 510.

3. The decision of the United States Circuit Court of Appeals in holding that the dual position occupied by

Thomas N. Dysart, chairman of the Bondholders' Committee and chief sponsor of the plan, and his conflicting loyalties may be disregarded as not material considerations in the determination of the fairness and equity of the plan, is in conflict with the following applicable decisions of the Supreme Court of the United States:

American United Mutual Life Insurance Company v. City of Avon Park, 311 U. S. 138;
Woods v. City National Bank and Trust Company, 312 U. S. 262.

V.

PRAYER FOR WRIT.

Wherefore, your petitioner, Scherck, Richter Company, prays that a writ of certiorari be issued to review the judgment (R. 222) entered on November 17, 1941, in the United States Circuit Court of Appeals for the Eighth Circuit in the above-entitled cause.

Respectfully submitted,

SCHERCK, RICHTER COMPANY,
Petitioner,

By LYLE M. ALLEN,
B. L. LIBERMAN,
Its Counsel.